

# J. F. Williams Co.

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*Jim Williams*

## **A look Back**

With the completion of 20 years of operations, I hope you enjoy a glimpse back at what we were (I was) thinking about 20 years ago, and how things have changed (and what has stayed the same).

Our investment management process began as a careful and laborious screening and filtering and analysis of actively managed mutual funds, primarily looking for No-Transaction-Fee funds on the Schwab OneSource platform. This process consisted of many components and many aspects. The screening encompassed virtually the entire mutual funds universe. The initial screen was the availability on the OneSource platform, followed by an evaluation of historical performance, along with attributes of expense ratios, manager tenure, turnover ratio, percent cash (un-invested), and on and on.

Another component of the mutual fund analysis was the practice of talking with mutual fund sales people who would attend various industry functions put on either by Schwab, the Financial Planning Association, or other trade groups. These folks invariably were well versed in the means and methods of presenting their funds in the best possible light. Frequently this was supplemented by conversations with the mutual fund managers themselves. They, likewise, were well schooled at making the case for their particular funds. I remember taking an interest in the opinions of other advisors in the same business and considering the funds that they held in favor. There was a time when I subscribed to newsletters that evaluated and recommended various actively managed funds. Then, I subscribed to a newsletter that evaluated investment newsletters.

These are the two essential components of any attempt to pick winning mutual funds: history and story. History appeals to the analytical side because it is finite, objective and certain. It can be analyzed down to three digits to the right of decimal point. The fundamental problem with history is the well-known refrain that “past performance is not an indicator of future performance”. This simple fact proves itself over and over again. The other component of picking funds is the story, which generally purports to reveal the future. The story may be delivered in marketing materials, by fund wholesalers, or by the fund managers themselves. It may be “anchored” in history. It doesn’t take long to learn that they all have good stories. Remember the stories about fund managers picking up manhole covers to go into the manhole and look at stuff? Pretty compelling; also pretty meaningless as a means of assessing future performance of a mutual fund. Turns out, there is no reliable or objective way to evaluate story. It is generally an appeal to emotion, even if it is wrapped around mountains of data.

At the bottom of the mutual fund analysis process was the search for Alpha, or market-beating performance. This search was driven by the desire to meet the expectations of the broadest population of the investing public, many if not most of whom expect their investment manager to “beat the market”. Most funds underperform their benchmark, and the few that beat their benchmark in one year, are unlikely to beat it again the following year. This is not to say that outperformance never happens. It does. It is just nigh impossible to reliably spot it in advance. So most of the consequence of effort to pick winning mutual funds (or to pick winning stocks) ends up a matter of chasing performance. Chasing performance is a toxic and wasteful behavior when it comes to the management of investment assets.

Because active management has a high propensity to disappoint, we turned to an evidence-based approach that works with the market rather than against it. We harvest market-based returns less expenses and taxes, knowing that, over time markets are pretty generous. By minimizing expenses and taxes, we maximize returns to the client. We eschew the urge and impulse to predict market outcomes. We manage exposure to systematic risks and curtail idiosyncratic risk. Now, rather than trying to “beat the market” we are the ones everyone else is trying to beat.

In our quarterly reviews, going back to inception, we see Dimensional Funds showing up fairly early on. It was not love at first sight, but as I came to understand more and more behind the underpinnings of Dimensional’s approach, we as a firm embraced the evidence-based investment philosophy we now hold. We continue to review the mutual funds in the portfolios on a quarterly basis. Even though we are closely aligned and allied with the Dimensional Funds and with Vanguard, they are “trust but verify” relationships. Also, we continue to evaluate other mutual funds that we find in client 401(k) and other qualified plan accounts that we manage for them. These funds are selected by the investment committees of the qualified plans, and we can only make the best of what we find there.

Investment policy and asset allocation was driven through a Mean Variance Optimizer program. These were popular at the time, but again, in a short time it became clear that the results of the optimization process were so heavily influenced by assumptions, that variations in allocation policy were not only unstable but meaningless. Following the example of Roger Gibson, the author of the original Asset Allocation book, I devised a stable framework to use in the development of asset allocation targets for client portfolios. This framework has been in place since late in the year 2000, and has since served our clients and us well through solid growth and through a good bit of market turbulence.

The financial planning component of our services started out with elaborately detailed planning analyses, built

piece-by-piece in Excel (the electronic spreadsheet that remains the standard). These analyses were built to forecast cash flow, including taxes; income, expenses, and balance sheets for a life expectancy. I lavished hundreds of hours into some of the early planning efforts, rationalizing that I was building tools that could be readily re-used time-after-time in the future. It didn't take long for me to realize that was a false hope. Had I stayed on that track, the firm would have been, by necessity, a software firm, selling planning software to other planners and doing full time software updating and maintenance. I wanted to do real planning for real people, so I chose to find off-the-shelf planning software that I could use without modification.

Our planning is now more personal and personalized. We place more emphasis and importance on understanding our clients at a deeper level. We are stronger in the follow-up processes related to planning.

What has stayed the same.

We have always been, and will always be fiduciaries for our clients. Our commitment to a Fee-Only business model is unwavering. We continue to believe that our clients prefer honesty and straight talk over hype and hot air. We

value integrity, professionalism, empathy, humility, and curiosity. We are committed to building and maintaining long-term, high-value relationships that make a lasting-positive difference in our client's lives.

A new team member

This month, Juan Guevara joined our firm as an Associate Financial Planner. Juan was born in Ecuador, and when he was a teenager, his family immigrated to California. Juan has a degree in Business Administration - Finance from California State University – Northridge. He has completed Kaplan University's CFP® Board-Registered Education Program and is working towards obtaining his CERTIFIED FINANCIAL PLANNER™ certification. His prior experience in personal financial planning will be put to use in working closely with Matt and Jim to help clients reach their life goals.

Juan's interests outside of work are time with his family, soccer, do-it-yourself projects, cooking and music.

The table below shows the returns through December 31, 2015 for selected investment asset classes. In most cases, the results below are appropriate benchmarks for the related mutual funds in your investment portfolio.

| Asset Class                            | Data Series   | YTD    | 1 Yr.  | 3 Yrs. | 5 Yrs. |
|--|---|--------|--------|--------|--------|
| Ultrashort Bonds                       | BofA Merrill Lynch Three-Month US Treasury Bill Index         | 0.05   | 0.05   | 0.05   | 0.07   |
| Short Term Municipal Bonds             | Barclays Capital Municipal Bond Index 3 Years                 | 1.18   | 1.18   | 1.24   | 1.81   |
| Short Term Government Bonds            | Barclays Treasury Bond Index 1-5 Years                        | 0.92   | 0.92   | 0.65   | 1.24   |
| Short Term Corporate Bonds             | BofA Merrill Lynch 1-5 Year US Corporate and Government Index | 1.05   | 1.05   | 0.96   | 1.68   |
| Short Term Global Bonds                | Citigroup World Government Bond Index 1-3 Years (hedged)      | 0.71   | 0.71   | 0.81   | 1.04   |
| Intermediate Term Municipal Bonds      | Barclays Capital Municipal Bond Index 7 Years                 | 3.26   | 3.26   | 2.76   | 4.48   |
| Intermediate Government Bonds          | Barclays Capital US Government Bond Index Intermediate        | 1.18   | 1.18   | 0.81   | 2.02   |
| Intermediate Corporate Bonds           | Barclays Capital Credit Bond Index Intermediate               | 0.90   | 0.90   | 1.61   | 3.63   |
| Intermediate Global Bonds              | Citigroup World Government Bond Index 1-5 Years (hedged)      | 1.00   | 1.00   | 1.17   | 1.58   |
| US Marketwide Core 1 & 2               | Russell 3000 Index  | 0.48   | 0.48   | 14.74  | 12.18  |
| US Marketwide Vector                   | Russell 2500 Index  | -2.90  | -2.90  | 12.46  | 10.32  |
| US Large Cap Market                    | S&P 500 Index   | 1.38   | 1.38   | 15.13  | 12.57  |
| US Large Cap Value                     | Russell 1000 Value Index                                      | -3.83  | -3.83  | 13.08  | 11.27  |
| US Small Cap Market                    | S&P Small Cap 600 Index                                       | -1.97  | -1.97  | 13.57  | 11.48  |
| US Small Cap Value                     | Russell 2000 Value Index                                      | -7.47  | -7.47  | 9.06   | 7.67   |
| Real Estate Investment Trusts          | Dow Jones US Select REIT Index                                | 4.48   | 4.48   | 11.76  | 12.32  |
| International Marketwide Core & Vector | MSCI World ex USA Index (net div.)                            | -3.04  | -3.04  | 3.93   | 2.79   |
| International Large Cap Market         |   |        |        |        |        |
| International Large Cap Value          | MSCI World ex USA Value Index (net div.)                      | -7.68  | -7.68  | 1.99   | 1.90   |
| International Small Cap Market         | MSCI World ex USA Small Cap Index (net div.)                  | 5.46   | 5.46   | 7.82   | 4.39   |
| International Small Cap Value          |   |        |        |        |        |
| Emerging Markets                       | MSCI Emerging Markets Index (net div.)                        | -14.92 | -14.92 | -6.76  | -4.81  |

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